INDEX

	Page
Opinion	1
Jurisdiction	1
The question	2
Statutes involved	2
Statement	3
Argument:	
I. Respondent is not entitled to exemption from Federal taxation under the provisions of section 234(4) of the revenue act of 1918 as a domestic building and loan association:	
A. The fact that a corporation is organized and operated under the building and loan laws of a State is not conclusive as to its right to exemption under section 231(4) of the revenue act of 1918	7
B. It is not the name "building and loan association" which is exempt under section 231(4) of the revenue act of 1918, but the collective activities which are ordinarily carried on under that name	8
The fundamental characteristics of a building and loan association	9
Respondent during the years 1918, 1919, and 1920 had departed basically and fundamentally from the primary purposes and objects of a building and loan association as generally known and recognized by the courts	10
II. Substantially all of respondent's business during the calendar years 1921, 1922, and 1923 was not confined to making loans to members	11
III. Provisions granting exemption from taxation to be construed strictly in favor of the Government	15
Conclusion	15

CITATIONS

Cases:

Acklin v. Peoples Saving Association, 293 Fed. 392	9
Bank of Commerce v. Tennessee, 161 U. S. 134	15
Boston and Maine R. R. v. United States, 295 Fed. 578	8
Cornell v. Coyne, 192 U. S. 418	15

Cases—Continued.	Page.
Everman v. *Schmitt*, 53 Ohio St. 174	9
Lilley Building & Loan Co. v. *Miller*, 280 Fed. 143; affd. 285 Fed. 1020; certiorari denied, 262 U. S. 754	9
N. Y., N. H. & H. R. R. Co. v. *United States*, 269 Fed. 907	8
United States v. *Childs*, 266 U. S. 304	8
United States v. *Dickson*, 15 Pet. 141	15
Statutes:	
Revenue Act of 1918, c. 18, sec. 231, 40 Stat. 1057, 1076	2
Revenue Act of 1921, c. 136, sec. 231, 42 Stat. 227, 253	3
Textbooks:	
Endlich, Law of Building Associations, secs. 1 and 7	10
Sundheim, Law of Building and Loan Associations (2d ed.), 1922, secs. 3 and 7	10

In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 700

THE UNITED STATES, PETITIONER

v.

THE CAMBRIDGE LOAN AND BUILDING COMPANY

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

OPINION

The opinion of the Court of Claims (R. 11) is not yet reported.

JURISDICTION

The judgment of the Court of Claims was rendered on June 6, 1927 (R. 18). The United States filed a motion for new trial on August 5, 1927 (R. 19), which was overruled on October 17, 1927 (R. 19). The petition for writ of certiorari was filed on January 16, 1928 (R. 19). Jurisdiction of this court is invoked under the Act of February 13, 1925.

THE QUESTION

1. Is respondent entitled to exemption from Federal taxation under the provisions of Section 231 (4) of the Revenue Act of 1918 for the calendar years 1918, 1919, and 1920, as a domestic Building and Loan Association?

2. Is respondent entitled to exemption from Federal taxation under the provisions of Section 231 (4) of the Revenue Act of 1921 for the calendar years 1921, 1922, and 1923, as a domestic Building and Loan Association, substantially all of the business of which was confined to making loans to members?

STATUTES INVOLVED

The pertinent provision of the Revenue Act of 1918, relative to the exemption of domestic building and loan associations from income taxes and applicable to the calendar years 1918, 1919, and 1920, is to be found in Section 231 (c. 18, 40 Stat. 1057, 1076), reading as follows:

CONDITIONAL AND OTHER EXEMPTIONS

> SEC. 231. That the following organizations shall be exempt from taxation under this title [Part III—Corporations]:
>
> (4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit.

The pertinent provision of the Revenue Act of 1921, relative to the exemption of domestic building

and loan associations from income taxes and applicable to the calendar years 1921, 1922, and 1923, is to be found in Section 231 (c. 136, 42 Stat. 227, 253), reading as follows:

> CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS
>
> SEC. 231. That the following organizations shall be exempt from taxation under this title [Part III—Corporations]:
>
> (4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit.

STATEMENT

This is a suit to recover Federal income tax paid by respondent for the years 1918 to 1923, both inclusive. The years 1918, 1919, and 1920 are controlled by the Revenue Act of 1918, and the years 1921, 1922, and 1923 are controlled by the Revenue Act of 1921. The pertinent portions of both Acts are above set out.

The Government contends that under both Acts a building and loan association to be entitled to exemption must conduct its business as a building and loan association in fact and not merely be designated as such under the laws of the State of its origin. The Government further contends that a building and loan association accepting large

sums of money from nonmember depositors, regardless of the borrowing needs of its members, for the purpose of lending the same to nonmembers, is in fact conducting a savings-bank business and is not entitled to exemption as a building and loan association. The Government also contends that, under the Act of 1921, substantially all of the business of a building and loan association must be confined to making loans to members, and that in this case the respondent, during the years 1921, 1922, and 1923, which are controlled by the 1921 Act, did a very large and substantial part of its business with nonmembers. The Court of Claims in substance and effect held that under either Act a building and loan association recognized as such under the laws of the State of its origin is entitled to exemption under the Revenue Acts merely because defined as a building and loan association by State law. A judgment was rendered against the Government in the sum of $17,174.67, which included the taxes paid for all of said years involved and interest thereon.

The findings by the Court of Claims show that respondent was an Ohio corporation, organized under the laws of that State authorizing the creation of building and loan associations (R. 8); that it made its reports to and was inspected by the superintendent of building and loan associations of the State of Ohio and invested its funds in the manner prescribed and permitted under the laws of said State, reporting its investments annually

to the State authorities (R. 8). During the time here involved the net profits of respondent, except such as were set aside as a reserve under the State laws and retained as undivided profits, were distributed as dividends to members. (R. 8.) The money raised by respondent during the years involved was principally from payments on stock, from deposits by nonmembers, and from interest on money temporarily deposited by it in banks or loaned to other building and loan associations. (R. 9.) Deposits by nonmembers were evidenced by certificates of deposit, or by pass books, and could be withdrawn upon notice, and respondent paid interest thereon. (R. 9.)

The respondent's assets and liabilities at the end of the calendar years 1918 to 1923, inclusive, are set out in the findings. (R. 9.) Finding VII shows that during said years respondent made substantial loans to other building and loan associations. The proportion of such loans to the assets for each of said years, respectively, is as follows:

1918—10.2%; 1919—13.1%; 1920—7.2%;
1921—3.8%; 1922—6.1%; 1923—9.9%.

This statement of liabilities shows that during the same period respondent had on hand large sums of deposits and accrued interest. (R. 9.) The proportion of such deposits and interest to the total liabilities for each of said years is as follows:

1918—53.3%; 1919—59.3%; 1920—60.2%;
1921—60.8%; 1922—61%; 1923—62.8%.

Finding VIII (R. 10) shows the loans made to members and nonmembers during the period involved. If we consider the table from the standpoint of the total number of loans shown for each year, we find the proportion thereof made to nonmembers during each year as follows:

1918—57.3%;	1919—35%;	1920—40.1%;
1921—23.9%;	1922—20%;	1923— 9.6%.

If we consider it from the standpoint of the total amount of the loans shown for each year we find the proportion of loans to nonmembers as follows:

1918—75.3%;	1919—38.4%;	1920—55.4%;
1921—44.5%;	1922—35%;	1923— 1.7%.

It will be noted that the business with nonmembers materially decreased in 1923. The Government introduced evidence, which was not disputed, that respondent made loans to persons who subsequently took nominal stock subscriptions of one or two shares to qualify them as stockholders, not taking the usual number of shares to equal the amount of their loans, and it was also undisputed that it was conceived that this would reduce the tax liability. The Government requested a finding of fact to this effect, but the court failed to make such a finding.

There was a stipulation by the parties before the court showing mortgages in substantial amounts purchased by respondent. A stipulation also shows that respondent accepted large deposits from nonmembers, and the evidence shows this was done regardless of the borrowing needs of its members.

The stipulation also showed the number of depositors and the number of stockholders in the years involved, as follows:

	1918	1919	1920	1921	1922	1923
Stockholders	1,250	1,000	1,040	1,000	1,172	901
Depositors	1,550	1,922	2,085	2,200	2,410	3,025

The Court of Claims failed to make any findings upon these very material and pertinent facts though requested to do so, which request was vainly renewed in the Government's motion for new trial.

As stated in our petition for writ of certiorari, if the writ is granted we will ask this court to remand the case for full findings upon these important matters, if the facts as found are inadequate to sustain our position.

ARGUMENT

I

Respondent is not Entitled to Exemption from Federal Taxation Under the Provisions of Section 231 (4) of the Revenue Act of 1918 as a Domestic Building and Loan Association

A

The fact that a corporation is organized and operated under the building and loan laws of a state is not conclusive as to its right to exemption under section 231 (4) of the revenue act of 1918

It is well settled that a Federal tax law may not be abridged or enlarged by the force of local statutes.

United States v. *Childs*, 266 U. S. 304, 309;

N. Y., N. H. & H. R. R. Co. v. *United States*, 269 Fed. 907;

Boston and Maine R. R. v. *United States* (C. C. A. 1st), 265 Fed. 578.

The contention that a building and loan association, *eo nomine*, because organized and operating under the laws of a particular State is *ipso facto*, exempt, regardless of the fact that it has departed from the business of a true building and loan association and is in fact conducting a banking business, would, if admitted, result in a total lack of uniformity in the administration and application of the Federal statute.

Certainly Congress could not have intended that State laws and State decisions should determine the exemption or nonexemption of building and loan associations, wholly disregarding the nature and character of the business done, because permitted by State laws.

B

IT IS NOT THE NAME "BUILDING AND LOAN ASSOCIATION" WHICH IS EXEMPT UNDER SECTION 231 (6) OF THE REVENUE ACT OF 1918, BUT THE COLLECTIVE ACTIVITIES WHICH ARE ORDINARILY CARRIED ON UNDER THAT NAME

A building and loan association to be entitled to exemption from Federal taxation must be operated in accordance with the principles uniformly recognized by courts and text writers. If these recognized fundamental aims and purposes are

lacking, calling the corporation in question a "building and loan association" will not make it such in fact. It is not the name "building and loan association" which is exempt. The name is immaterial. It is the actual operations of the organization that must determine its status within the meaning of the Federal statute and it is clear that a corporation, a large part of whose business is borrowing moneys from the public for the purpose of making loans to the public for the profit of its stockholders, although permitted by the laws of a particular State so to do, thus in effect operating as an ordinary banking institution, is not entitled to exemption as a building and loan association under Federal statutes simply because so named.

The fundamental characteristics of a building and loan association.

A building and loan association is a corporation organized primarily for the purpose of enabling its members, by small periodical payments on loans made from funds contributed by its members, to build or acquire homes, and in which the members of the association share in the profits and in the losses on the basis on essential principle of mutuality, reciprocity, and equality.

> *Eversmann* v. *Schmitt*, 53 Ohio State 174;
> *Lilley Building & Loan Co.* v. *Miller*, 280 Fed. 143, Affirmed (C. C. A. 6th), 285 Fed. 1020, Certiorari denied, 262 U. S. 754;
> *Acklin* v. *Peoples Savings Association*, 293 Fed. 392;

Sundheim, Law of Building and Loan Associations (Second Edition, 1922, Sections 3 and 7);

Endlich, Law of Building Associations (Sections 1 and 7).

Respondent during the years 1918, 1919, and 1920 had departed basically and fundamentally from the primary purposes and objects of a building and loan association as generally known and recognized by the courts.

Finding VII (R. 9) of the Court of Claims shows that the bulk of respondent's funds employed in its business was not received from its members but from deposits from nonmembers, evidenced by certificates of deposit and pass books upon which it paid interest at 3, 4, 5%. (Finding VI, R. 9), which deposits and accrued interest amounted to the sum of $510,688.30 at the end of 1918, $664,371.72 at the end of 1919, and $810,451.88 at the end of 1920, the amounts increasing for the years 1921 and 1922 and reaching the sum of $1,142,796.73 at the end of the year 1923 (R. 9).

Meanwhile, as shown by the court's Finding VIII (R. 10), respondent in 1918 made 44 member loans, amounting to $32,260.00, as against 59 nonmember loans, amounting to $98,689.00; in 1919, 169 member loans, amounting to $194,035.50, as against 91 nonmember loans, amounting to $121,438.70; and in 1920, 152 member loans, amounting to $186,756.45, as against 102 nonmember loans, amounting to $232,472.42, and accepted as security homes, real estate,

farms, business property, churches, and collateral security just as would be the case in loans made by an ordinary savings and mortgage company.

Respondent in accepting large deposits from nonmembers in the years 1918, 1919, and 1920, regardless of the borrowing needs of its members and for the purpose of realizing profits from its loans to the general public, was but following the methods and practices of ordinary loan companies and banks, and was not, because thereof, entitled to exemption as a building and loan association.

When the common purpose manifest throughout Section 231 is considered, it seems clear that Congress had no intention of exempting such organizations. In no other subdivision of Section 231 has exemption been granted to organizations doing business for profit with the general public and the granting of such exemption by subdivision (4) to so-called building and loan associations would be contrary to the whole spirit and purpose of the rest of the section.

II

Substantially all of Respondent's Business During the Calendar Years 1921, 1922, and 1923 was not Confined to Making Loans to Members

Congress in enacting the exemption provisions of the Revenue Act of 1921 recognized that the primary object and purpose of a building and loan association is to raise money to be loaned to its

members, and by Section 231 (4) it provided for the exemption of only those associations "substantially *all the business* of which is confined to making loans to members," and not that substantially all of its loans shall be made to its members, which seems to be the construction placed by the Court of Claims upon this exemption provision.

The court below in its Finding of Fact VIII (R. 10) found that during the calendar years 1921, 1922, and 1923 respondent made loans to members and nonmembers in numbers and amounts as follows:

Members		Nonmembers	
Number	Amount	Number	Amount
1921—161	$256,170.00	57	$205,645.00
1922—180	209,900.35	65	113,530.00
1923—272	668,111.98	29	10,565.00

Under the above finding of the court the percentage of loan to members and nonmembers during said years was:

1921—To Members, 55.5%; To Nonmembers, 44.5%.

1922—To Members, 65%; To Nonmembers, 35%.

1923—To Members, 98.3%; To Nonmembers, 1.7%.

It was stipulated as a fact, however, by the parties that respondent purchased mortgages for investment amounting to $27,378.63 in 1921; $5,086.40 in 1922; and $14,117.50 in 1923. These amounts were excluded by the court from its Finding VIII,

and clearly constituted business done by respondent for the respective years with nonmembers.

If these amounts are included as business done with nonmembers, together with loans made to members and nonmembers as found by the court in its Finding VIII, the percentage of business done with members and nonmembers in the respective years is as follows:

1921—Members, 52.3% ; Nonmembers, 47.7%.
1922—Members, 63.9% ; Nonmembers, 36.1%.
1923—Members, 96.1% ; Nonmembers, 3.9%.

The undisputed evidence showed that after the passage of the 1921 Act requiring substantially all business to be done with members, this respondent adopted the practice of making members of those it desired to do business with by issuing to them small or nominal amounts of stock, without any relation to the extent of the association's other transactions with them. The court below failed, though asked, to make any finding covering this point.

Furthermore, the court's Finding VII (R. 9) shows that after satisfying the borrowing needs of both members and nonmembers, respondent had loaned to other building and loan associations and other financial institutions the following amounts, upon which it received interest (Finding VI, R. 9):

	1921	1922	1923
Deposits in other building and loan associations	$55,500.00	$90,000.00	$101,500.00
Deposits in other financial institutions		10,000.00	15,000.00

Petitioner requested the Court of Claims to find said amounts loaned by respondent to other building and loan associations and financial institutions as a separate finding of fact, but the court refused such separate finding and excluded said amounts from its computation of business done with nonmembers in its Finding VIII. (R. 10.)

The Government contends that such requested finding was material and that the amounts loaned by respondent for profit to other building and loan associations and other financial institutions within the meaning of said Section 231 (4) of the Revenue Act of 1921 constituted business done with nonmembers.

Including as business done with nonmembers said loans made by respondent to other building and loan associations and other financial institutions, the percentage of business done with members and nonmembers for the respective years is as follows:

1921—Members, 46.8% ; Nonmembers, 53.2%.
1922—Members, 48.5% ; Nonmembers, 51.5%.
1923—Members, 73.7% ; Nonmembers, 26.3%.

It is clear that as to the calendar years 1921 and 1922, even under the court's Finding VIII (R. 10), substantially all of respondent's business was not confined to making loans to members, and that as to the calendar year 1923 respondent was not entitled to exemption since by the purchase of mortgages and loans made for profit to other building and loan associations and other financial institu-

tions substantially all of respondent's business was not confined to making loans to members.

III

Provisions Granting Exemption from Taxation to be Construed Strictly in Favor of the Government

Respondent in this case is claiming the benefit of a special exemption from taxation granted by Congress to domestic building and loan associations, and the rule is firmly established that where an exemption from taxation is claimed the burden is upon the claimant to conclusively establish in law and in fact that it is within the terms thereof.

United States v. *Dickson*, 15 Pet. 141;
Bank of Commerce v. *Tennessee*, 161 U. S. 134, 146;
Cornell v. *Coyne*, 192 U. S. 418.

Conclusion

One of the cardinal principles which should guide a trial judge is to give the defeated party complete and fair findings of fact, so as to enable him to fairly make his points on appeal. That has not been done in this case.

There are a large number of cases similar to this pending in the courts and in the Bureau of Internal Revenue, arising under the 1918 Act and also under the 1921 Act. There are thousands of so-called building and loan associations in the United States. The provisions of the 1921 Act have been reenacted

in the later revenue Acts. A decision in this case is desirable, to guide the Treasury Department and the courts in dealing with these cases. The decision of the Court of Claims runs counter to the practice heretofore followed by the Treasury Department in dealing with these cases. The findings as they stand present a strong case for the United States, but if the Court of Claims had included in its findings additional facts established or stipulated and which the United States asked to be included the record would have been clear.

Respectfully submitted.

WILLIAM D. MITCHELL,
Solicitor General.

HERMAN J. GALLOWAY,
Assistant Attorney General.

FEBRUARY, 1928.

○